

Office of Chief Counsel  
Internal Revenue Service

**memorandum**

TL-N-4010-99  
JForsberg

date: November 8, 1999

to: Wanda Gorell  
Chief, Technical Division, ESB  
North Central District

from: District Counsel, North Central Region

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subject: [REDACTED]  
Sequa Interest Claim

This is in response to your request for advice as to the dates from which interest accrues on the deficiencies assessed for [REDACTED]'s taxable years. [REDACTED] and [REDACTED].

Issue

Under the facts set forth below, from what dates does interest accrue on the deficiencies assessed for [REDACTED]'s taxable years [REDACTED] and [REDACTED]?

Conclusion

Where a taxpayer has reported an overpayment on its return for year 1 and has elected to have the overpayment applied to its estimated taxes for year 2, and where a deficiency is assessed for year 1 in an amount which is less than the amount of the overpayment, interest does not accrue on the deficiency until, and only to the extent, the overpayment has been reduced below the amount of the deficiency by having been applied to year 2's estimated taxes, or, to the extent the overpayment is not fully used to satisfy year 2 estimated taxes, until the original due date of the year 2 return.

In this case, interest accrues as follows: With respect to the [REDACTED], no interest accrues on the deficiency until [REDACTED], the original due date of the [REDACTED] return. With respect to the [REDACTED], no interest accrues on that portion of the deficiency equal to the [REDACTED] overpayment (\$[REDACTED]) until [REDACTED], the original due date of the [REDACTED] return, and interest begins to accrue on the \$[REDACTED] balance from [REDACTED], the original due date to the [REDACTED] return.

Facts

████████████████████ (the "taxpayer") has a taxable year ending February 28. Pursuant to extension, the taxpayer's ██████ return was timely filed on or about ██████. The ██████ return showed a tax liability of \$██████, and an overpayment of \$██████, which the taxpayer elected to apply to its ██████ estimated tax liability. The taxpayer did not designate the quarterly estimated tax payment to which the overpayment was to be applied.

██████: The taxpayer made the following estimated tax payments for ██████:

<u>Installment Period</u>	<u>Estimated Tax Due<sup>1</sup></u>	<u>Estimated Tax Payment</u>	<u>Overpayment/ (Underpayment)</u>
████████████████████	\$██████	\$██████	\$██████
████████████████████	████████████████████	██████	(████████████████████)
████████████████████	██████	██████	██████
████████████████████	██████	██████	██████
	\$████████████████████	\$██████	\$ (████████████████████)

Pursuant to extension, the taxpayer's ██████ return was timely filed on or about ██████. The ██████ return showed a tax liability of \$██████, and an overpayment of \$██████, which the taxpayer elected to apply to its ██████ estimated tax liability. The taxpayer did not designate the quarterly estimated tax payment to which the overpayment was to be applied.

██████: The taxpayer made the following estimated tax payments for ██████:

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<sup>1</sup> The quarterly estimated tax payments due are per the taxpayer's fax of ██████. We have not verified the correctness of the taxpayer's computation.

<u>Installment Period</u>	<u>Estimated Tax Due<sup>2</sup></u>	<u>Estimated Tax Payment</u>	<u>Overpayment/ (Underpayment)</u>
██████████	\$ █████	\$ █████	\$ █████
██████████	█████	█████	█████
██████████	█████	█████	█████
██████████	█████	█████	█████
	<u>\$ █████</u>	<u>\$ █████</u>	<u>\$ █████</u>

The taxpayer subsequently filed amended Forms 1120X for █████ and █████ showing additional tax due for those years of \$ █████ and \$ █████, respectively. Said amounts were assessed on █████, and █████, respectively. In computing the amount of interest due on the deficiencies for █████ and █████, the service used █████, and █████, respectively (the original due dates of the taxpayer's █████ and █████ returns) as the dates on which interest began to accrue on the deficiencies.

On or about █████, the taxpayer filed protective claims for deficiency interest for █████ and █████ based on the May Department Stores and Sequa Corp. cases.

#### Discussion

In May Department Stores Co. v. United States, 36 Fed. Cl. 680 (1996), 1996-2 U.S.T.C. ¶ 50,596, acq. 1997-2 C.B. 1, the taxpayer elected to credit an overpayment shown on its 1983 return to its 1984 estimated tax liability but failed to designate the quarterly payment to which the overpayment was to be credited. The Service subsequently determined a deficiency for 1983 and assessed interest on the deficiency from the due date of the first installment for 1984 in accordance with Rev. Rul. 88-98. The taxpayer, however, had made estimated tax payments for the first and second quarters of 1984 sufficient to avoid the addition to tax imposed by section 6655. The Court of Federal Claims held that the Government had had the use of taxpayer's overpayment from the due date of the first installment

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<sup>2</sup> The quarterly estimated tax payments due are per the taxpayer's fax of █████. We have not verified the correctness of the taxpayer's computation.

to the date taxpayer filed its 1983 tax return since the overpayment was not needed to satisfy either the first or second estimated tax payments.

In light of May Department Stores, the Service has modified the manner in which it will compute interest on a deficiency for a year where the taxpayer elected to apply an overpayment shown on that year's return to the succeeding year's estimated taxes. Rev. Rul. 99-40, 1999-40 IRB 1 (September 16, 1999) provides that in such a case, the overpayment will be applied to the unpaid installments of estimated tax due on or after the date the overpayment arose in the order in which they are needed to avoid the imposition of an addition to tax for failure to pay estimated income tax under sections 6654 and 6655. Interest on the subsequently determined deficiency will then accrue from the date, and to the extent, the unapplied overpayment is no longer adequate to satisfy the deficiency. In determining when an overpayment is to be applied to estimated tax installment, any excess payments made for prior installments are to taken into account.

Rev. Rul. 99-40 does not address the issue of when interest begins to accrue on a deficiency where all or part of the overpayment is not needed to satisfy the succeeding year's estimated tax liability. It is the Service's position that in such a case, the overpayment should be treated as a payment of the succeeding year's income tax. Section 6513(d) provides:

If any overpayment of income tax is, in accordance with I.R.C. § 6402(b), claimed as a credit against estimated tax for the succeeding tax year, such amount shall be considered as a payment of the income tax for the succeeding taxable year (whether or not claimed as a credit in the return of estimated tax for such succeeding taxable year), and no claim for credit or refund of such overpayment shall be allowed for the taxable year in which the overpayment arises.

Under sections 6513(a) and 6151, the due date of the succeeding year's return is the last date on which an overpayment could be credited as a payment of the succeeding year's tax. Further, this is also the date the overpayment is treated as a payment for purposes of computing interest on any overpayment of income taxes with respect to the succeeding year under sections 6611(a) and (d). Accordingly, the statute requires that an overpayment which the taxpayer elects to credit against the succeeding year's estimated tax must be treated as a payment against the succeeding year's tax liability no later than the due date of the succeeding year's return.

In the present case, the taxpayer's [REDACTED] overpayment would be applied to the taxpayer's [REDACTED] estimated tax liability as follows:

[REDACTED] Overpayment	\$ [REDACTED]
Applied to 1st Quarter Payment	[REDACTED]
Unapplied Overpayment as of [REDACTED]	\$ [REDACTED]
Applied to 2nd Quarter Payment	[REDACTED]
Unapplied Overpayment as of [REDACTED]	\$ [REDACTED]
Applied to 3rd Quarter Payment	[REDACTED]
Unapplied Overpayment as of [REDACTED]	\$ [REDACTED]
Applied to 4th Quarter Payment	[REDACTED]
Unapplied Overpayment as of [REDACTED]	\$ [REDACTED]

The amount of the unapplied overpayment for [REDACTED] (minimum of \$ [REDACTED]) at all times exceeded the deficiency for that year (\$ [REDACTED]). As the unapplied overpayment was at all times sufficient to satisfy the deficiency, no interest begins to accrue on the deficiency until [REDACTED], the original due date of the [REDACTED] return.

With respect to [REDACTED], no part of the overpayment for that year was required to be applied to the taxpayer's [REDACTED] estimated tax liability. Therefore, no interest begins to accrue on that portion of the deficiency equal to the [REDACTED] overpayment (\$ [REDACTED]) until [REDACTED], the original due date of the [REDACTED] return. However, as to the \$ [REDACTED] excess of the deficiency (\$ [REDACTED] - \$ [REDACTED]), interest will accrue from the original due date to the [REDACTED] return.

If you have any questions respecting this matter, please call Jack Forsberg at (651) 290-3473, ext. 227.

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cc: Assistant Chief Counsel  
(Field Service)